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SUBJECT: MOLDOVAN 2008 MACROECONOMIC OVERVIEW

REF: CHISINAU 08 0227

¶1. (SBU) SUMMARY: Economic growth continued to be strong in Moldova in 2008, according to recently released official statistics, with GDP growing 7.2 percent. However, economic trends were not uniform during the year and fourth quarter data reflected the increasing impact of the world economic crisis on Moldova. GDP growth was driven largely by soaring remittances while industrial output grew a disappointingly 0.7 percent. The 2008 Consumer Price Index (CPI) remained below double digits for the first time in six years at 7.3 percent. The local currency, the Moldovan Leu (MDL), remained stable and even appreciated over the year. The total external trade grew with a sharp increase in imports. Moldova continued to increase exports to the EU with the share growing to 51.6 percent. The National Bank of Moldova (NBM) intervened in the foreign exchange market buying foreign currency and in the last four months of the year also selling foreign currency to support the MDL. By the end of 2008, it became obvious that MoldovaQs modest macroeconomic success in the first eight months of 2008 was being affected by the impact of the global economic crisis, and that the negative trends would persist into 2009. END SUMMARY.

GDP GROWTH SLOWED IN THE LAST QUAURTER OF 2008
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¶2. (U) Moldova's GDP was (MDL) 62.840 billion (around USD 6 billion) in 2008. This amount represented an increase of 7.2 percent compared to 2007 according to Moldova's National Statistics Bureau (NSB). This growth exceeded the 6 percent forecast by the Government of Moldova (GOM) for the year. GDP growth more than doubled from 3 percent in 2007, when Moldova suffered a severe drought decimating the agricultural sector. Although GDP was strong for the year, economic growth was very uneven. GDP grew by 4.3 percent in the first quarter, 6.2 percent in the second quarter, 10.8 percent in the third quarter and slowed in the fourth quarter. The NSB has not provided the figure for the final quarter.

¶3. (U) According to official statistics, GDP growth was driven largely by good performances in goods and services, including transportation, retail and construction. Large remittances equaling 27 percent of GDP from Moldovans working abroad continued to drive the increase in the populationQs purchasing power. According to the NBM, remittances for yet another year grew substantially from USD 1.2 billion in 2007 to over USD 1.6 billion in 2008.

INDUSTRIAL OUTPUT INCREASED A MODEST 0.7 PERCENT

¶4. (U) According to NSB preliminary data, the overall industrial output in 2008 was MDL 29.66 billion (USD 2.85 billion) in current prices which was, adjusted for inflation, a very modest 0.7 percent more than in 2007. The monthly industrial production index based on 2007 numbers was up and down during the year. (Note: In 2006 industrial output fell by 4.8 percent and in 2007 by 1.3 percent. The economy was hit hard in 2006-2007 by RussiaQs ban on Moldovan wine imports and by an increase in natural gas prices effective April ¶2006. End Note). Despite the efforts of the GOM to project confidence that Moldova had dodged the global economic crisis in advance of general elections in April 2009, it was obvious that the downturn began affecting Moldova in late 2008. For the last three months of 2008, the industrial production index dropped below 100 to 97 percent in October, 94.9 percent in November, and 95.5 percent in December.

¶5. (U) In 2008, the food processing and beverages subsector, which represents some 43 percent of the industrial sector, grew by 10 percent. Improvement in this sector was substantial due to the poor harvest in 2007 because of the severe drought and the Russian embargo on wines and agricultural products in 2006 and 2007. In 2005 this subsector was around 50 percent of Moldovan industrial production. Some of the best performing areas registering increased production were sugar by 82 percent, wine by 26 percent, bread by 7.1 percent, distilled alcoholic drinks by 6.2 percent, dairy products by 6 percent, and processed and canned meat by 3.8 percent. Strong performance in this subsector contributed to a 4.1 percent increase in overall industrial production. The economy also increased output in metal production by 30.5 percent, chemical production by 15.4 percent, wood processing and manufacture of wood articles by 13.4 percent, furniture by 8 percent, and apparatus and precision medical equipment by 4.2 percent. However, the share of each of these subsectors in total industrial production was minimal varying between 1.5 and 0.2 percent. Some of the subsectors that showed a significant decline in production included textiles by 8.8 percent, articles from textiles by 15 percent, footwear by 2.3 percent, paper and cardboard production by 29 percent, machine production by 13 percent, cement and gypsum production by 12.5 percent, and glass and glass items by 2.6 percent. The decline in these subsectors resulted in a large negative impact on overall industrial production.

AGRICULTURAL PRODUCTION JUMPED 31.9 PERCENT

¶6. (U) Annual agricultural production in current prices was MDL 16.41 billion (USD 1.58 billion) for 2008, an increase of 28 percent over the previous year. In constant prices, i.e. prices adjusted for inflation, agricultural output was 31.9 percent greater than in 2007 when the country suffered a severe drought. As a result of a good harvest in 2008, growth in agricultural production was 69 percent in the crop-growing sector. Unfortunately for farmers, the bumper harvest in the region led to lower prices for agricultural products. Meanwhile, animal production decreased by some 20 percent as a result of many farmers having slaughtered their livestock during the drought the previous year. The 2008 agricultural performance appears more impressive compared to

2007 when agricultural production dropped by 23 percent from the previous year because of the drought.

SINGLE -DIGIT INFLATION

¶7. (U) The CPI rose by 7.3 percent for 2008. This increase compares favorably to 2007 when CPI rose by 13.1 percent. Food prices grew by 6.5 percent, non-food items by 2.1 percent, and services by 17.5 percent. The greatest price increase in the services was due to more expensive energy resources. Moldovans saw the tariff for utilities increase 29.2 percent. The greatest increase in utilities was in central heating which grew by 75.9 percent. Interestingly, the city government in the capital of Chisinau continued to charge the lowest tariffs for central heating in the country. The municipality subsidized tariffs and ran up huge debts with the heating company. The consumer costs for public transportation increased by 20.1 percent.

¶8. (SBU) The GOM and NBM both took credit for the first year of single digit inflation since 2002. For the past five years, Moldova experienced double-digit inflation rates, ranging from 15.7 percent in 2003 to 10 percent in 2005. Since 2006, the primary objective of the BNM has been to maintain price stability and a stable market-based financial system. Prior to 2005, the BNM's main objective had been to maintain local currency stability. Much of the credit for the GOM's performance in controlling inflation goes to the IMF which had pushed the government to enact tight fiscal policies by running small to zero budget deficits.

NATIONAL CURRENCY APPRECIATED OVER 2008

¶9. (U) For the year, the official nominal exchange rate of the national currency, the Moldovan Leu, appreciated against the USD by 8.12 percent, from MDL 11.3192 per USD as of December 31, 2007 to MDL 10.4002 at the end of 2008. During the year, the exchange rate was influenced by the significant interference of the NBM in buying and selling dollars at various times of the year. From January to May, the BNM bought USD 61 million, and in the following three months, July to August, another USD 222 million. Beginning in September, the BNM intervened by both buying and for the first time in 2008 selling USD. The BNM purchased USD 118.5 million and sold USD 163 million in the last four months of the year.

EXTERNAL TRADE WAS UP AND THEN DOWN

¶10. (U) The total trade figure for 2008 was 29 percent greater than in 2007. According to the NSB preliminary data, annual external trade was USD 6.496 billion for 2008. The trade consisted of USD 1,597 billion in exports and USD 4.899 million in imports representing a 19 percent increase in exports and a 32.8 percent increase in imports. The stronger growth in imports led to a sharp increase in the trade deficit, which exceeded USD 3.3 billion. Moldovan exports remained concentrated in the EU market, with the share slightly increasing to 51.4 percent in 2008 compared with 50.6 percent in 2007. At the same time, the share of exports to CIS countries decreased to 39.3 percent from 41 percent in 2007. Imports from the EU comprised 43 percent, compared with 45.6 percent in 2007. Imports from CIS

countries also decreased, dropping to 35.5 percent from 36.1 percent in 2007. Imports from countries other than the EU or CIS increased to 21.5 percent from 18.3 percent in 2007.

¶11. (U) As in previous years, Russia, Ukraine and Romania remained Moldova's largest trading partners. Moldovan-Russian trade totaled USD 985 million, or 15 percent of total trade. Moldovan-Ukrainian trade was almost the same at USD 982 million (15 percent). Moldovan-Romanian trade was USD 927 million (14 percent). Moldova's other important trade partners were Italy with USD 473 million (7.3 percent), Germany with USD 428 million (6.6 percent), China with USD 325.5 (5 percent), Belarus with USD 292 million (4.5 percent), and Turkey with USD 265 million (4 percent).

CHANGES IN MOLDOVA'S IMPORT AND EXPORT MARKETS
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¶12. (U) In 2008, for the first time, Romania became the leading export nation for Moldovan goods with USD 336 million of imports, 21 percent of all Moldovan exports. Russia was the second largest market for Moldovan exports with USD 318 million or 19.9 percent of Moldova's total exports. The following export markets by country were Italy (10.5 percent), Ukraine (9 percent), Belarus (5.8 percent), and Germany (4 percent). (Note: In 2006, the Russian ban on imports of Moldovan wine and agricultural products led to a 47.6 percent drop in Moldova's exports to Russia and an increase in exports to Romania, Ukraine, Belarus, some partners from the EU, and several other countries. The share of Moldovan exports to Russia declined considerably from 31.8 percent of total exports in 2005 to 17 percent in 2006-2007. Nevertheless, Russia remained the leading market for Moldovan exports until 2008. End Note)

¶13. Ukraine has been Moldova's main supplier of imports since 2001. In 2008, imports from Ukraine were USD 839 million (17 percent of total imports). Imports from Russia were USD 666 million (13.6 percent), followed by Romania with USD 591 million (12 percent), Germany with USD 365 million (7.5 percent), China with USD 325 million (6.6 percent), and Italy with USD 306 million (6.3 percent). Imports from all the major importers increased considerably compared to the previous year. The increases were 22 percent from Ukraine, 33.6 percent from Russia, 32 percent from Romania, 14 percent from Germany, 60 percent from China, and 14 percent from Italy.

¶14. (U) Moldova's major exports were textile and articles from textile (USD 314 million or 20.6 percent of total export), food stuffs (processed animal and vegetable products) and wines (USD 312 million, or 20.6 percent), and products of vegetable origin (fresh, dried or frozen fruits and vegetables) (USD 210.1 million or 12 percent). Major imports were mineral products (USD 1,126 million or 23 percent of total imports), machinery, apparatus and equipment (USD 765.5 million or 15.6 percent), chemical products (USD 416.8 million or 8.5 percent), and transport means (USD 391 million or 8 percent). Both exports and imports declined in the last quarter of the year.

COMMENT

¶15. (SBU) Although the end-of-year numbers for the Moldovan economy were still positive, the last quarter of 2008 indicated that the economic crisis

had already begun to affect Moldova significantly. The GOM continued to display confidence in the economy through the first three months of 2009 leading up to the general elections on April 5. However, we expect the numbers for the first quarter of 2009 to tell a different story. IMF informed us that remittances have dropped significantly in the first quarter of 2009. The GOM derives approximately 70 percent of its revenue from taxes and duties on imports which will decline as remittances drop and imports decrease. There are reports that the government has not paid Moldovan embassy staff overseas for two months. According to EU sources the GOM diverted the most recent tranche of 12 million Euros that was meant for budget support to pay foreign debt. These actions might be consequences of the GOM's aggressive intervention in the financial market to prop up the Leu in the months leading up to the elections. The new government will have to focus on the economy and face up to IFIs recommendations including reducing government payrolls and procurement. Since the April 5 elections, Moldova has been bogged down in a political crisis and it will still take some time before a new government is named.

CHAUDHRY